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Pensions&Investments

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AT DEADLINE

GTE to realign equities

GTE is restructuring its defined benefit plan's more than $4 billion domestic equity portfolio — and its managers — following an intensive review, sources say.

The review was done to help create a "more structured approach to the asset/liability framework" of the portfolio.

Brunswick OKs private vote

Brunswick Corp. has agreed to adopt comprehensive confidential voting procedures, under an agreement with the United Shareholders Association.

Mayor gains fund power

The Illinois Legislature passed a bill giving Chicago Mayor Richard M. Daley the power to replace two ex officio trustees of the city's $2.074 billion municipal pension board and three ex officio members of the $687 million laborers' pension board. City Treasurer Miriam Santos, who sits on both boards, opposed the measure.

Underfunding up $10 billion

The amount of underfunding in the defined benefit plan system has grown to at least $40 billion, up $10 billion from last year, according to PBGC estimates.

Reasons for the increase include weak investment returns and benefit increases in several underfunded union pension plans.

L.A. County shifts assets

The $11.4 billion **Los Angeles County Employees' Retirement Association** selected Morgan Grenfell Asset Management and UBS Asset Management as international equity managers for Europe. The firms likely will be given $120 million each.

INSIDE

GREG LOUDON

Reaching for the dough

Pension cookie jars, with $3 trillion in collective assets, have been alluring targets for public, union — and corporate — officials seeking to pursue economic and political agendas. In Commentary, Page 14.

FRED WILLIAMS

One Dallas Centre needs money for leasing commissions, renovations and debt.

Crow eats adviser fee to rescue realty fund

By Steve Heinerick

DALLAS — Trammell Crow Realty Advisers has offered to give up $6.5 million in management fees as part of an attempt to rescue its troubled $421 million vulture fund as well as its credibility with fund investors.

The fund's investors' committee verbally approved the strategy in September, said Robert Whitman, managing partner with Trammell Crow Ventures and supervisor of the fund.

In addition to forgoing $6.5 million in fees due Crow over the next three years, the strategy involves refinancing a healthy property in Trammell Crow Equity Partners I fund to provide $4.5 million and restructuring, in a small way, the debt of another property in the fund.

The $11 million would be used to rescue the troubled One Dallas Centre, the fund's main property. It would be used to pay leasing commissions for new tenants, tenant renovations and debt.

The One Dallas Centre troubles were the crowning blow in a series of surprises described by investors and Mr. Whitman that has pushed the Trammell Crow Equity Partners I fund to have a return of −15% since its inception.

One investor, Barry L. Stevens, director of the Bureau of Investments for the Michigan Department of Treasury, said of the rescue plans: "It is a difficult situation. It is taking a lot of our time and the other limited partners' time. It's a little premature to say where we and the other limited partners are going to come

See **Crow** *on page 51*

Small-cap firms hit limits

Investors find fewer managers taking new business

By Fred Williams

The strong demand for small-capitalization managers has forced an estimated 20% of such firms to refuse new business.

As a result, executives with the Case Western Reserve University Endowment, Cleveland; the Navy Exchange Service Retirement Plan Trust, New York; and the Fleming Cos. Inc. pension fund, Oklahoma City, all have found a shrinking universe while conducting small-cap manager searches.

The supply of managers could tighten further as latecomers launch searches in the aftermath of the run-up in small-cap stock prices.

Small-cap stocks — out of favor for several years — began to rally last November. For the first three quarters of 1991, the NASDAQ OTC Composite Index is up a smashing 40.9%, compared with 20.4% for the Standard & Poor's 500 Stock Index. Many market analysts predict a continued bull market for small-cap stocks.

The small-cap boom has pushed many managers up against their pre-established limits on the amount of assets under management to avoid a liquidity crunch in a thinly traded market. Plus, the number of shares available is not as large as in the large-cap market.

Nola Williams, vice president and research analyst at The Frank Russell Co., Tacoma, Wash., said 18 of the 85 small-cap managers in the Russell universe have closed to new business, 11 in the past 18 months. A spokeswoman for Wilshire Associates Inc., Los Angeles, said 20% to 25% of the 70 to 90 small-cap firms in the Wilshire universe are refusing to take new business.

Both said other established small-cap managers are expected to reach their capacity as investors continue to pour money into the hot asset class.

"Only those with less experience will be left," Ms. Williams said.

"The pace seems to be slowing somewhat, but I wouldn't stretch out a manager search for any lengthy period of time and expect to find someone with a wealth of experience in the small-cap area."

Among those that have reached their capacity in one or more small-cap funds are Brinson Partners Inc., Wall Street Associates, Westport Capital Management, Peregrine Capital Management Inc., Duncan-Hurst Capital Management, Capital Technology Inc., Frontier Capital Management Co., Jundt Associates Inc., Cadence Capital Management Corp. and Morgan Grenfell Capital Management Inc.

Most of the managers that have stopped taking on new business are small-cap growth managers; small-cap value managers still have capacity, according to consultants.

Kathleen Chapman, director of investments at Case, said the $425 million fund started its search in January and finally hired three small-cap managers in August.

See **Limits** *on page 54*

Fleming Cos., which owns several grocery store chains, has found fewer firms from which to choose in seeking a small-cap manager.

GM drawn to First Exec bid

Gets 25% of equity for standby pledge

By Anne Schwimmer

General Motors Corp.'s pension fund is contributing up to 25% of the $300 million in equity for a bid to purchase First Executive Life Insurance Co.

GM's equity participation was used as a lure by the other three members of the group bidding for the troubled insurer. They used the equity to entice the GM pension fund to commit to funding at least 25% of the additional $700 million standby guaranty also proposed by the group as part of its bid.

GM officials didn't return telephone calls, but the fund's involvement was confirmed by Warren Hellman, a general partner of Hellman & Friedman, San Francisco, which is leading the bid.

The other partners in the group are Zell/Chilmark Fund L.P., Chicago, and Fund American Cos. Inc., Purchase, N.Y.

Each is contributing $75 million to the equity portion.

The standby guaranty would provide extra capital in the form of loans if necessary.

The other partners "would rather have more of the equity" in the First Executive deal, but brought GM pension fund in on the deal because "the $700 million standby for the three of us was a lot," Mr. Hellman said.

NEWS DIGEST

TED FUKA

The 401(k) plan — now 10 years old — changed the structure of retirement income provision in the United States. But it was created by accident, not specific design. See page 17.

A federal magistrate's recommendation could drive thousands of multiemployer health plans to seek ERISA certification from the Department of Labor. Page 30.

Critics charge the PBGC is "crying wolf" by using scare tactics to push its own agenda for reforms and is not in dire financial straits. Page 34.

FINANCING

Demand for new stock offerings is unquenched, despite the huge wave of such offerings, because cash reserves and deal quality both remain high. Page 3.

Spanish market watchers are awaiting a spate of stock offerings by large, government-controlled companies that are expected to be well-received. Page 38.

INTERNATIONAL

The California State Teachers' Retirement System began implementing a global investment strategy by allocating $2.5 billion to 10 equity managers. Page 2.

The European Commission is busily devising proposed rules to liberalize investing for European pension funds as part of the 1992 changes. Page 3.

Pension officials, state treasurers and money managers are heeding the Soviet Union's call for investments and other forms of aid. Page 3.

Pension fund hirings of international managers are down about 40% so far this year, a phenomenon some experts say is only temporary. Page 36.

The Australian public pension fund system has spun off its investment arm into a separate entity called Commonwealth Funds Management. Page 40.

REAL ESTATE

Trammell Crow Realty Advisers offers to give up management fees as part of a plan to rescue a troubled vulture fund. Page 1.

Five retired Eastern Airlines pilots sue over the status of their defined contribution plan, saying it is illiquid because of its heavy allocation to real estate. Page 4.

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Fund hires 10 for global

California Teachers allocates initial $2.5 billion

By Steve Hemmerick

SACRAMENTO, Calif. — The $38 billion California State Teachers' Retirement System has begun implementing a global investment strategy, allocating $2.5 billion to 10 international equity managers.

The fund, which had no non-U.S. investments before, intends to invest the $2.5 billion over the next two years. The plan is to increase the international commitment to $5.7 billion or 15% of assets and, long term, to 25% of assets.

"We are trying to put the foundation on our international diversification strategies," said Tom Flanigan, chief investment officer.

The move had been delayed since April because some of the managers didn't understand state regulations "over the minimum qualifications relative to minority participation. We successfully reinforced that," he said.

The retirement system selected five active international managers that may invest in a mix of European and Japanese security markets, two active European managers, two active Pacific Basin managers and one passive international manager.

Each will be given at least $100 million; the allocations have not yet been decided, said Mr. Flanigan.

The active managers will have full discretion over country and stock selection decisions within their respective geographic mandates. The passive manager's geographic focus has not yet been decided.

"We believe that because of the South African consideration here, which eliminates about 40% of the stocks in EAFE, we may only activate a Pacific Basin index. We haven't made that decision yet, but it is a fairly safe assumption," Mr. Flanigan said.

The firms will be evaluated against a South Africa-free version of either the Morgan Stanley Capital International Europe Australia Far East Index or one of the regional subindexes.

The five active international managers selected are: Morgan Stanley Asset Management, New York; Lazard Freres Asset Management, New York; J.P. Morgan Investment Management Inc., London; PCM International Inc., Short Hills, N.J.; and Capital Guardian Trust Co., Los Angeles.

The two active European managers are: Morgan Grenfell Asset Management, London, and Oechsle International Advisors, Boston.

Selected as active Pacific Basin managers were: Schroder Capital Management International Ltd., London, and Dunedin Fund Managers Ltd., Edinburgh, Scotland.

Wells Fargo Nikko Investment Advisors, San Francisco, is the passive manager.

Under California law, "a firm has to attempt to do 20% of (its) business with woman- and minority-owned firms, subcontracting

See **Global** *on page 52*

SEC Chairman Richard C. Breeden blasted the Business Roundtable for its "hyperactive imagination."

Breeden reaffirms proxy reform effort

By Marlene Givant Star and Joel Chernoff

WASHINGTON — Securities and Exchange Commission Chairman Richard C. Breeden rebuffed efforts by the Business Roundtable to block liberalization of federal proxy rules.

In testimony before the Senate Securities Subcommittee Oct. 17, Mr. Breeden criticized the influential business group for carrying on a "disinformation effort" about the SEC's proposed proxy rule changes.

In particular, he discounted the Roundtable's charges that rule changes allowing "disinterested" shareholders to communicate with each other without filing proxy materials would permit stockholders to form cabals and plot in "smoke-filled rooms."

"I think we have a hyperactive imagination here at work," Mr. Breeden told the subcommittee.

Mr. Breeden's strong support of the SEC's proxy proposals heartened shareholder activists. Some had worried the commission's support for proxy reform was wavering in light of SEC Commissioner Richard Y. Roberts' comment to the American Society of Corporate Secretaries earlier this month that comprehensive proxy reform was dead, and "few addi-

See **Proxy** *on page 53*

Transfer could cut GIC rates

By Hillary Durgin

NEW YORK — Pension funds with Mutual of New York GICs face the prospect of lower rates of return and some delayed payments if they transfer their contracts to Metropolitan Life Insurance Co.

Under an agreement reached by the two mutual insurance companies last week, MONY clients may transfer virtually all of their $1.5 billion in guaranteed investment contracts to Met Life.

Met Life, however, has agreed to pay MONY's interest rate — which averages 9%, but ranges between 8% and 11% — on only one-fifth of the book value of the GICs for the life of the contracts.

According to Felix Schirripa, vice president of pensions at Met Life, MONY's rates of return are about two percentage points higher than those "currently available in the marketplace."

Rates of return on the remaining 80% of book value likely will be lower after the first year.

MONY clients transferring their GICs would re-invest them in a Met Life separate account that will have the same, average maturity of six years. The separate account will pay a rate of return through the end of 1992 based on market conditions on the Dec. 2 transfer date.

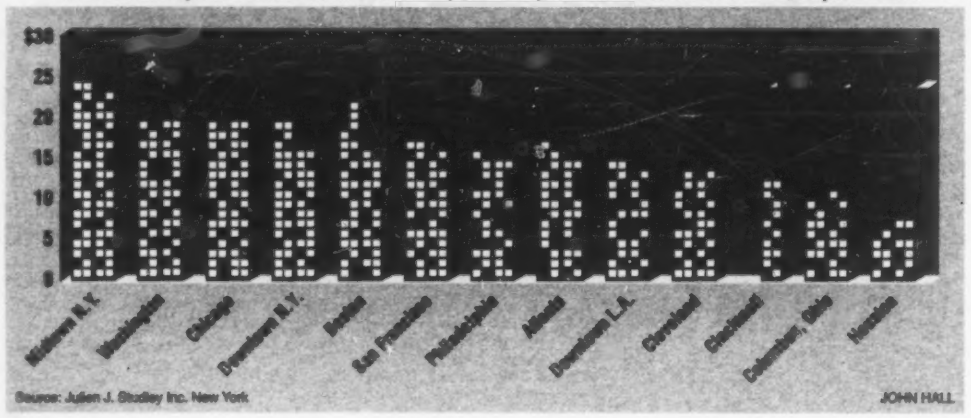
"If the average customer now has a 9% three-year deal, I believe it might be fair to say that the 9% likely will be preserved or there may be something better than 9% during the first year," said Mr. Schirripa.

"The portfolio will have assets relative to Treasuries that at least initially will earn attractive spreads . . . (and) will at least initially compensate the contract holders for the risk they are taking."

See **Transfer** *on page 51*

Comparison of average net rents

All prices are per rentable square foot and exclude concessions. Numbers represent new building construction for "Class A" office space in central business districts (1989-1991). Numbers also reflect full-floor, 10-year leases.



Source: Julien J. Studley Inc. New York JOHN HALL

REAL ESTATE

Tenants gain the upper hand in down office market

■ Tenants have more leverage in the current office rental market than at any time during the past 10 years, a survey shows.

The survey by Julien J. Studley Inc., a New York-based commercial real estate firm, shows "all components of rent are negotiable," said Jacque Ducharme, senior vice president and head of the survey.

Concessions — such as free rent and the dollar amount provided by the landlord for tenant improvements — hit $115 per square foot in Washington, $114 in Chicago and $90 in midtown New York and downtown Los Angeles, but were as low as $17.50 per square foot in Houston.

Average net rents (the basic annual rent calculated on a per-square-foot basis, excluding the tenant's share of tax and operating expenses) increased only in Washington, Houston and Columbus, Ohio, during the past year.

Net rents decreased in New York, Chicago, Boston, San Francisco, Philadelphia, Atlanta, Los Angeles and Cleveland.

Midtown New York is the most costly office market, with total rentals averaging $47 per square foot for new, Class A space. Houston is the cheapest, at $19 per square foot.

— *Nancy K. Webman*

INTERNATIONAL

L.A. County sets regional approach

■ The $11.4 billion Los Angeles County Employees' Retirement Association is trying to regionalize its international manager lineup, said Charles Conrad, administrator.

Toward that end, the fund hired Nomura Investment Management Co. Ltd., Tokyo, and Schroder Investment Management Ltd., London, as Far East international equity managers.

Each will receive about $120 million.

Funding for the pair and for one or more European managers expected to be hired in about 60 days will come from existing international managers, but it has not been decided from which ones.

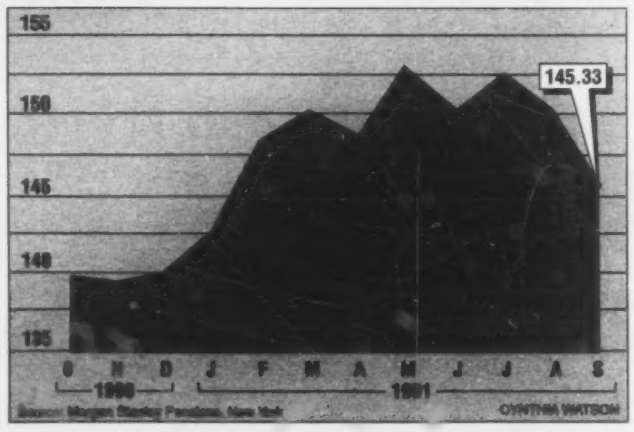
Part of the money will come from a terminated EAFE account with Daiwa International Capital Management Corp., New York.

Trustees also selected Delta Asset Management Co., Los Angeles, as a domestic equity manager. Mr. Conrad said Delta will receive about $200 million, which will come from an account with Security Pacific Investment Managers Inc., Los Angeles. Security Pacific was dropped because of personnel changes, he said.

Callan Associates, San Francisco, assisted in the selection of Delta. The Frank Russell Co., Tacoma, Wash., assisted in the selection of the international managers.

— *Steve Hemmerick*

Pension surplus index



Source: Morgan Stanley Pensions, New York CYNTHIA WATSON

FINANCING

Courier company is taken private

■ BancBoston Ventures Inc. has invested $3.65 million in CDG Holding Corp., a company formed to take Courier Dispatch Group Inc. private.

Ingoldsby, O'Connor, Altwell & Co., a Waltham, Mass.-based investment bank, initiated the transaction and worked with BancBoston in structuring and arranging the financing.

"The investments of BancBoston Ventures and other institutions will allow us to restructure the ownership of the company, which, in turn, will provide us with the opportunity for continued growth. Equally important, the change in ownership will provide us with the foundation to streamline operation, reduce costs and make selected acquisitions," said Paul R. Dean, president of Courier Dispatch, Atlanta.

Now that the company is private, BancBoston Ventures owns about 30%. Fleet Venture Partners, a unit of Fleet/Norstar Group, Providence, R.I., invested about $200 million, and owns 22% of the company. Management will remain in place, and Mr. Dean will assume the additional title of chairman of the board.

Courier is a full-service organization providing both scheduled on-call ground and air courier services. Revenue totaled $55 million in the year ended June 30.

BancBoston Capital, the venture firm's parent, and its affiliates claim to have the largest bank-sponsored mezzanine and venture capital business in New England and one of the largest in the country with more than 200 investments.

— *Marlene Givant Star*

PEOPLE

UMWA's Clark takes consulting role

■ After nearly six years on the job, Jerry N. Clark has resigned as executive director of the $5 billion-plus UMWA Health and Retirement Funds to set up his own health cost management consulting firm.

Mr. Clark said that while he enjoyed the challenge of overseeing the mine workers' benefit funds, he always had wanted to return to the health care area. His new firm, Clark Associates, will be based in Washington.

Mr. Clark joined the UMWA funds as director of research in 1974, moved to director of options in 1983 and was promoted to executive director in 1985. Under his direction, the funds reduced annual per capital health cost increases to an average of 8%, down from double-digit levels earlier.

Edward A. Day Jr., director of finance and administration for the funds, has been appointed acting executive director.

— *Joel Chernoff*

UNIONS

Pension asset protection sought

■ The $2.3 billion Bakery, Confectionery and Tobacco Workers International Union wants Klosterman's Baking Co., Cincinnati, to guarantee any losses to the company's 401(k) plan, which the union said is 100% invested with Mutual Benefit Life Insurance Co.

The union questioned the investment choices at three non-union plants, claiming the seizure of Mutual Benefit by New Jersey regulators make Klosterman's morally — if not legally — responsible for any losses. Klosterman employees could invest in a guaranteed fund, equity growth or aggressive equity funds, a short-term money market account or a real estate fund.

The baker's union wants Klosterman's Bakery to protect workers' pension pie.

"No one's looking after these people, and we feel compelled to start looking after their welfare," said Dave Durkee, director of organization at the union. The union has lost elections at the Klosterman's plants in the past.

No matter what happens in the case of Mutual Benefit, the union is looking down the road to guarantee against losses to pensioners, Mr. Durkee added.

In a letter to Kenneth Klosterman Jr., president of the company, the union called for a program to protect non-union workers' pension assets. The union proposed Klosterman's guarantee the assets; provide immediate access to assets by employees; provide employees access to loans by setting up a loan fund; and make all information on New Jersey's rehabilitation order of Mutual Benefit and the 401(k) and profit-sharing plans available to employees.

The union also distributed form letters for the employees to send to the plan administrator to get information about the pension plan and all information concerning Mutual Benefit.

Klosterman's executives did not respond to telephone calls.

— *Sabine Schramm*

ECONOMY

Marinvest exec sees relief ahead

■ Sometimes you have to leave home to appreciate it.

John C. Quinn, who returned in July after more than seven years in Hong Kong, Singapore and Tokyo to become chief executive officer and chief investment officer of Marinvest, New York, is more bullish on the American economy than most U.S.-based analysts.

He believes the economy is well on the road to recovering from a severe hangover.

The hangover, he suggests, resulted from excesses that damaged the economy in the 1980s — inflation and high interest rates early in the decade, the strong dollar in the middle of the decade and the excesses in the real estate and financial sectors.

Now "the real economy is getting better, but the financial economy may deteriorate a little further," he said earlier this month.

"The deterioration of the financial sector may hide important productivity increases," he said. "I expect significant growth in the next year or so."

Even in the financial assets, the 1990s will provide favorable results because disinflation will continue, he said.

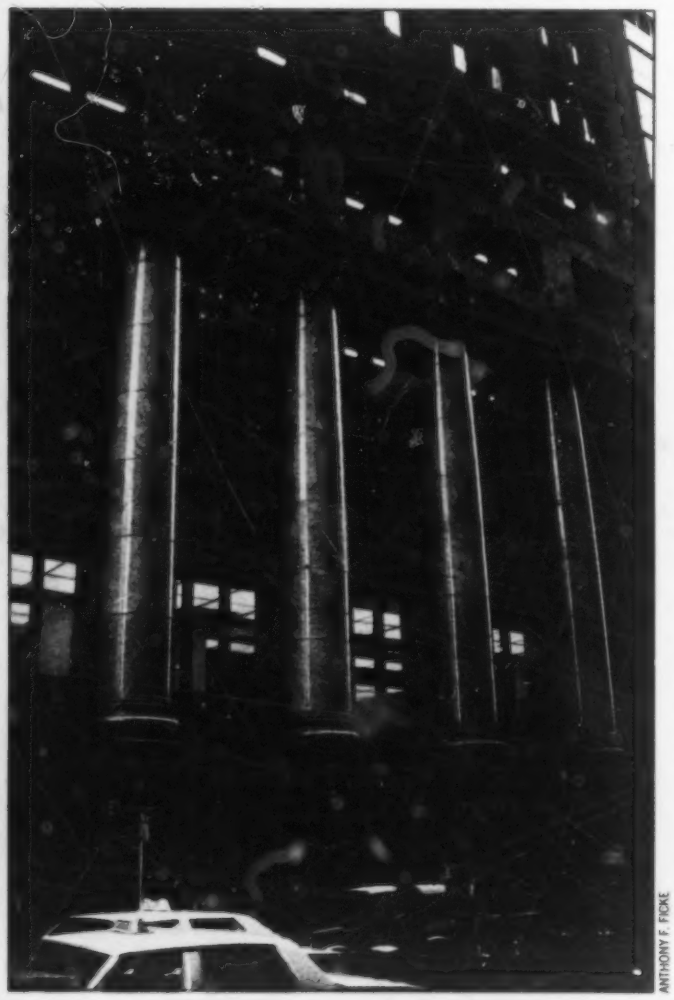
The greatest opportunities for growth, Mr. Quinn said, will belong to companies that have a global view — McDonald's Corp., Toys "R" Us Inc., Coca Cola Co., Pepsico Inc. and technology companies such as Hewlett-Packard Co. and Motorola Inc.

"American companies are going to have great success in the emerging countries because the average person in those countries aspires to the standard of living the average American already has," he said.

— *Mike Clowes*

BENEFITS

Group acts to cut FAS 106 liability



ANTHONY F. FICKE

The Bank of Montreal/Harris group, which includes Chicago's Harris Bank, expects to save $4.5 million in retiree health costs by requiring cost sharing by active employees.

■ The Bank of Montreal/Harris group of companies will save about $4.5 million under FAS 106 by altering its retiree medical plan effective Nov. 1.

Company executives estimate the liability under the Financial Accounting Standards Board's Statement 106 at $6.9 million under the new plan, vs. $11.4 million under the old plan. The bulk of the savings — $4 million — will come from requiring cost sharing by active employees ineligible for retirement.

Mary Wessel, vice president of Harris Trust and Savings Bank, Chicago, discussed the changes during a presentation to the Chicago chapter of WEB, a network of employee benefit professionals.

Although coverage remains the same, deductibles and the out-of-pocket limit will increase while co-insurance will decrease. Premiums — which used to be the same for all employees and were paid entirely by the bank for retirees older than 65 — now will be service related, meaning the longer employees work there before retiring, the less they pay. All retirees will contribute, paying an average of $7 to $35 per month.

And spousal coverage, which used to be free for retirees older than 65, now will cost $14 to $47 per month for all participants.

In addition, premiums for all retiree medical coverage now will be based on actual health care expenses for retirees. Before, they were based on expenses for active employees.

The Bank of Montreal/Harris is offering an early retirement incentive in conjunction with the announcement of the plan changes. Employees 55 or older with at least 10 years of benefit service may retiree by Oct. 31 and receive post-retirement medical benefits under the old plan, which is less costly to them. As a special enhancement, the bank will increase its contribution for employees at least 51 with at least six years of service by Nov. 1.

— Nancy K. Webman

MONEY MANAGERS

Ties that bind: Firm seals bank relationship

■ Don't tell Securities Counsel Inc. that banking has a bad name these days.

The investment advisory arm of First of America Bank Corp. and its Parkstone Group of mutual funds has renamed itself to more closely identify itself with the bank.

The new moniker, First of America Investment Corp., clearly cements the relationship begun when Securities Counsel, started in 1932 in Jackson, Mich., was bought by the Kalamazoo, Mich., bank in 1986. The investment adviser has about $800 million in tax-exempt assets under management, plus serves as adviser to the $2.8 billion Parkstone funds and the $4.5 billion bank trust department.

"The game used to be to separate the investment management culture from the bank culture through a name change," said Victor Melone, president and chief investment officer of of the former Securities Counsel.

"But that's ludicrous at this point when everyone knows banks are moving into all areas of the financial services industry. Why pretend that bank's aren't in the business?"

— Curtis Vosti

REAL ESTATE

Hotel industry slowly sinking

■ Just how bad is it in the hotel industry?

Coopers & Lybrand, in its quarterly research journal, "Coopers & Lybrand Hospitality Directions," reports an estimated $2.1 billion in hotel loans were delinquent or in the process of foreclosure as of Sept. 30, 1990. That's a 4.2% increase from 1989 despite a 2.7% drop in loans outstanding.

Hotel foreclosures more than tripled to $847 million during the first nine months of 1990, compared with the previous year.

Overall, delinquencies, foreclosures and restructured loans climbed 25.5% between the third quarter of 1988 and the third quarter of 1990.

"Weakness in the economy and declining real estate values will cause continued increases in the number and value of defaults and restructurings," said Bjorn Hanson, a C&L partner and hospitality industry consulting practice leader.

"Nearly 20% of hotels today are failing to fill half their rooms, an occupancy rate associated with severe financial losses. We expect the Resolution Trust Corp.'s current portfolio of about 155 hotels to rise if banks with loans outstanding to hotels continue to fail."

— Chuck Paustian

INVESTING

Equities, venture capital score big

■ The best-performing asset class in 1991 is expected to be U.S. equities and, over the next five years, venture capital.

That's one conclusion of the 15th annual survey of economic and capital market expectations conducted by the investment supervision consulting group at KPMG Peat Marwick, New York. Results came from a universe of 28 money managers, banks, insurance companies and the like.

Over a five-year period, U.S. and international bond returns are expected to be competitive with returns of U.S. and foreign equities. A global, multicurrency fixed-income portfolio is expected to outperform U.S. bonds over the long term while U.S. stocks are expected to outperform non-U.S. stocks over the long term.

Meanwhile, the expected equity risk premium is modest, indicating investors might not be compensated sufficiently for assuming the higher risk of stocks over bonds.

Respondents said inflation will remain subdued, while after-tax corporate profits will grow modestly over the long term. They predicted the federal budget deficit gradually will be reduced by modest amounts, and personal income and savings are expected to increase modestly over longer periods.

— Nancy K. Webman

Comparison of returns

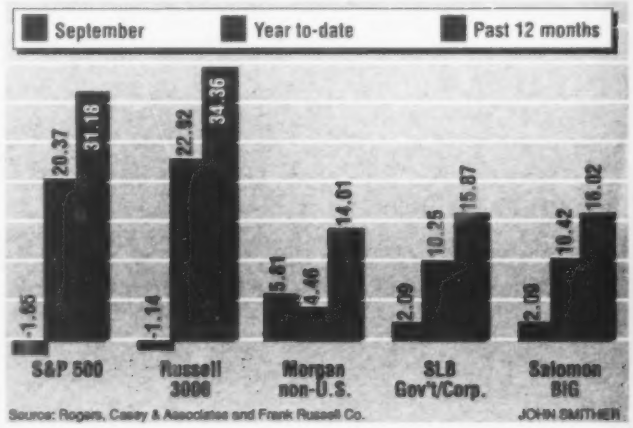
(Average value)

	1991	Next five years
Domestic equity	10.3%	10.7%
Non-U.S. stocks	8.4	10.3
Global stocks	9.9	10.2
Domestic fixed income	10.1	9.2
Non-U.S. bonds	8.3	9.4
Global bonds	9.3	9.4
Venture capital	6.9	11.6
Equity real estate	-5.4	3.1

Source: KPMG Peat Marwick, New York JOHN HALL

Pensions & Investments' indexes

The P&I monthly indexes track changes in the Standard & Poor's 500 Stock Index, Frank Russell Co.'s Russell 3000 Stock Index, the J.P. Morgan non-U.S. Government Bond Index, the Shearson Lehman Brothers Government/Corporate Bond Index and the Salomon Brothers Broad Investment Grade Bond Index.



Source: Rogers, Casey & Associates and Frank Russell Co. JOHN SMITHER

FINANCING

White knight receives just rewards

■ Polaroid Corp.'s white knight was rewarded for its good deed when the company divvied up the money remaining from its settlement in a patent battle with Eastman Kodak Co.

Some $280 million in cash and $140 million in 8% 10-year convertible debentures went to Corporate Partners, the $1.5 billion institutional limited partnership fund that provided $300 million of the financing for Polaroid's $1.1 billion stock buyback. The January 1989 buyback was used to fend off a takeover by Shamrock Holdings Inc., Roy E. Disney's investment group. Corporate Partners is managed by Lazard Freres & Co., New York.

Investors in the fund include California State Teachers' Retirement System, Sacramento; Florida State Board of Administration, Tallahassee; and Illinois State Board of Investment, Chicago.

In the original deal, CP received 10-year securities redeemable after seven years. Because Lazard knew Polaroid could receive a sizable settlement from Kodak before then, the firm negotiated a special call provision "in which Polaroid could take us out at a high rate of return," said Lester Pollack, senior managing director, Corporate Partners.

"Earnings per share and net income will go up as a result of the transaction. That makes it good for Corporate Partners to have a continuing interest in the company," said Mr. Pollack.

CP earned a return of close to 19% on its $300 million Polaroid investment, according to Mr. Pollack.

For Polaroid, the move reduces dilution associated with the payment-in-kind dividend that was paid to CP and eliminates the preferred cash dividend payout.

— Marlene Givant Star

401(k) 'clarification' a crossroads

Regulations changed retirement map

By Curtis Vosti

The employee benefit that has changed the structure of retirement income provision in the United States was created by accident, rather than by specific design.

The Internal Revenue Service issued regulations specifically allowing 401(k) salary reduction plans Nov. 10, 1981, paving the way for them to become the most popular employee benefit plan in the country during the next 10 years.

But the regulations grew out of part of the Internal Revenue Code enacted three years earlier to clarify that cash or deferred bonus plans — not pre-tax salary reduction plans — could be qualified plans.

"It was really an unconscious piece of legislation, but now it's Main Street America," said Dano Bartolai, principal with William M. Mercer Inc., Chicago.

"In those days, no one ever dreamed that 401(k) applied to anything but those (after-tax cash or deferred) types of pension plans," said Harry Gross, a partner with the Fort Lee, N.J., benefits consulting firm Kwasha Lipton.

Benefits consultant Ted Benna had grasped the concept in 1980, but had a hard time peddling the idea of a pre-tax plan until after the IRS regulations were published. *(See related story on this page.)*

"It was really just a technical correction," said Richard Pallan, senior managing director of The Putnam Cos., Boston. "But the companies that adopted 401(k) were the pioneers in the face of uncertain government regulation."

Now, as 401(k) plans enter their second decade, the phenomenal growth has in itself become a cause of increasing debate over their proper role. How do plan sponsors and individuals best use them? Where do they fit into the traditional concept of an individual's retirement income needs? What role will or should the government play in their development?

The answers that plan sponsors, individuals and the government give to these pertinent concerns will go a long way toward determining how the plans develop in the next 10 years.

Between 1984 and August 1991, the number of 401(k) plans has increased 150%, according to Buck Consultants Inc., New York, and the average participation rate has grown steadily to 74% from 62%.

Approximately 12 million people, or 14% of the private work force, are putting money into these plans, according to a 1989 report from the Social Security Administration.

At first, however, 401(k) growth came from the after-tax plans that had been waiting for the IRS clarification.

"In the early years, it was a no-brainer way to take after-tax plans and change them into pre-tax plans," recalled Mr. Bartolai.

"Almost all of them converted," said Susan Koralik, a partner with Hewitt Associates, Lincolnshire, Ill. "When it first came out, we were shocked, and then pleasantly surprised that the government would allow pre-tax contributions. And our clients were pleasantly surprised."

The plans were certainly enticing. An employee could not only use salary reduction, but also might get a company matching contribution on part of the savings and initially, at least, have fairly easy access to the account.

"It's the first time we've succeeded in getting the rank-and-file employees to save for retirement," said Edward Burrows, president of Pentad Corp., Waltham, Mass., and former president of the American Society of Pension Actuaries. "Contrasted with (individual retirement accounts), it was an outstanding savings vehicle. I don't think anyone had any inkling of the popularity that 401(k)s came to achieve."

The popularity also was fed by the ability of employees to direct their investments. As the plans grew in popularity, more options became available. Mutual funds, with their abilities to offer plan administration, toll-free phone service and numerous investment choices, became a dominant provider.

"In the old days, it was unusual to have more than two (choices), tops," said Mercer's Mr. Bartolai.

In 1989, according to the Department of Labor, 90% of plans with employee contributions allowed employees to direct their investments, and 73% of those allowed more than two choices.

And the choice of most employees became insurance company contracts. The onset of the plans fed into the explosion in the GIC market that took place in the late 1970s, when rates were in the double digits.

"401(k) provided an opportunity for insurance companies, who already had full-service capabilities in place and the guaranteed investment contracts, with their high rates, to make the plans successful," said James Hiner, a principal with Mercer, Chicago, who formerly worked in the in-

See **Crossroad** *on page 26*

JONATHAN WILSON

Ted Benna worked for almost two years before his 401(k) plan won IRS approval.

Creator faced long struggle

By Curtis Vosti

Ten years ago, Ted Benna chose a lonely path that would become a much-traveled road.

It seems so common now, even trendy. But it took Mr. Benna, a benefits consultant for the Newton, Pa.-based Johnson Cos., almost two years — until Nov. 10, 1981 — to get formal IRS sanction for his novel plan design based on the new, 401(k) section of the Tax Code added with The Revenue Act of 1978.

"I knew it was there, many people knew it was there, but it was unknown how it could be used," Mr. Benna says today in recollection of the impact of Section 401(k).

The idea came to him in January 1980, he has written, in response to prayer. He was working at home on a Saturday afternoon, mulling a new design for a bank client who was looking to transfer a cash bonus plan to a deferred profit-sharing plan.

He wanted features familiar today, but a cautious combination then — pre-tax salary reduction, company matches, employee contributions, high participation rates from even the lowest-paying workers and a more equitable distribution of benefits.

"I thought new tax savings alone would not be sufficient incentive for most employees to tie up money in a long-term investment plan," he said. "So I structured the plan to include matching contributions from the employer as an additional incentive to increased participation."

He packaged the product, calling it "Cash-Op." He knocked on doors, but not many were answered. "Some were concerned that the plans would be killed once it became clear what the revenue impact was," he said.

At the time, the concept of employee savings was attractive. Candidate and then President Ronald Reagan had been stressing the need to encourage personal saving through tax-deferred individual retirement accounts, known popularly as IRAs. Payroll deductions were allowed in 1981.

"We told them, 'You don't need to do that, there's something already there that's better than a payroll-deduction IRA,' " Mr.

See **Benna** *on page 24*

TED FUKA

Sponsors moved to fortify GIC selection

By Fred Williams

Sponsors of the largest defined contribution plans generally are comfortable with the safety of GIC issuers in their portfolio, but more than half have strengthened the GIC selection process in the past few months following the upheaval in the insurance industry.

The results of a *Pensions & Investments* telephone survey of more than 100 of the largest GIC holders indicate 57% of large plans have modified their GIC selection process in the aftermath of recent problems plaguing the insurance industry. Most respondents said they either have increased diversification standards by selecting a wider variety of carriers (45%) or by selecting carriers with higher credit quality (36%).

The survey — based on responses from 75 plan sponsors — was conducted by *P&I* during September and October in conjunction with Jeremy Gold Pensions, New York, and Spectrum Funding Corp., Long Beach, Calif.

Plan sponsors indicated almost unanimously that they were comfortable with the safety and creditworthiness of most contracts in their portfolios. However, 33% of the respondents said they were uncertain about the safety and creditworthiness of a small percentage of their holdings, usually less than 5% of the portfolio.

Some 91% of survey respondents said they are aware of the existence of a secondary market for GICs or the possibility of negotiating contract redemptions with issuers.

Murray Becker, principal with Becker & Rooney Inc., a Teaneck, N.J., GIC consulting firm that counts as clients some of the largest plan sponsors, said the concept of a secondary market has been tried but failed to catch on.

"The secondary market idea is of very limited value to begin with. . . . In a defined contribution plan most contracts are benefit responsive, and therefore you don't know what you are selling and insurance companies almost totally refuse to recognize assignments (of contracts). I've never had any client with any luck in a secondary market," said Mr. Becker.

"In theory you can do something like that; in practice no one does it. . . . As far as I'm aware it's not being done on any scale."

In a related question, 67% of respondents indicated they were aware some plan sponsors had purchased financial guarantees on GICs from a third-party guarantor to handle obligations in the event of a carrier default. Forty-nine percent indicated they would consider such a transaction.

"It may be possible to obtain a financial guarantee, but again this is not very practical," said Mr. Becker. "These ideas exist but are not useful in solving problems."

The use of synthetic or alternative contracts as a substitute for insurance contracts appears to be in far wider use than anticipated, as 60% of respondents said they

See **GICs** *on page 29*

Conservatism rules roost

Surveys say participants avoid risk, like to play it safe

By Curtis Vosti

Participants in 401(k) plans describe themselves as conservative investors who continue to prefer directing their investments toward insurance and bank contracts, according to two recent surveys.

While the surveys by John Hancock Financial Services Inc., Boston, and A. Foster Higgins & Co. Inc., Princeton, N.J., tend to confirm commonly held beliefs about 401(k) plan participants, they nevertheless offer insights into participant investment attitudes in the fast-growing and dynamic field of 401(k) plans.

The preference for less risky and lower returning investments, such as guaranteed investment contracts, has been a concern to many plan sponsors and benefits consultants because of its risk of providing lower-than-expected standards of retirement living.

Only 21% of those responding to the Hancock survey said they were willing to take risks with their accounts to get a better return. Forty-three percent disagreed.

The Hancock survey posed a number of statements, and participants were asked to indicate if they agreed with, disagreed with or were neutral about the statement. Hancock surveyed 946 individuals, mostly from larger corporations, who had contributed to a defined contribution plan having more than one investment option, one of which was a guaranteed fund.

More than eight out of 10 agreed with the statement, "I certainly am more conservative than experimental when it comes to financial matters."

The Foster Higgins survey indicated 58% of employee 401(k) assets were invested in insurance and bank contracts. Its results were based on answers from 516 employees in 401(k) plans. The assets reflected not only employee contributions but also company matches.

Company stock had 22% of employee 401(k) assets. Money market and equity funds each drew 21%, followed in order of preference by balanced funds, bond funds, government obligations, life insurance and real estate funds.

According to the Hancock survey, 80% of the respondents said they like to keep their financial affairs uncomplicated, with 19% agreeing with the statement that they need "very little advice when making financial or investment decisions."

Only 7% agreed with the statement, "the only way to succeed in today's financial world is to let professionals manage your money," and 26% agreed with, "what I really want is someone else to handle my finances for me with my best interests at heart." Forty-three percent disagreed with that statement.

"The survey clearly confirms that participants in 401(k) plans like to have control over their assets," said Joe LoRusso, second vice president of the Hancock investment and pension group.

Forty-three percent agreed with "once I decided how to invest my retirement savings I leave it alone and don't move it."

"Daily valuation and switching is not for everybody," Mr. LoRusso said. "They don't tend to want to move their money around."

Despite the popularity of participant control, sponsors are concerned participants don't understand the risk and reward trade-offs of various investments. While many sponsors think they must tread a fine line between offering investment information and recommendations, communication efforts are being stressed.

The Hancock survey attempted to determine the usefulness to employees of those communication efforts.

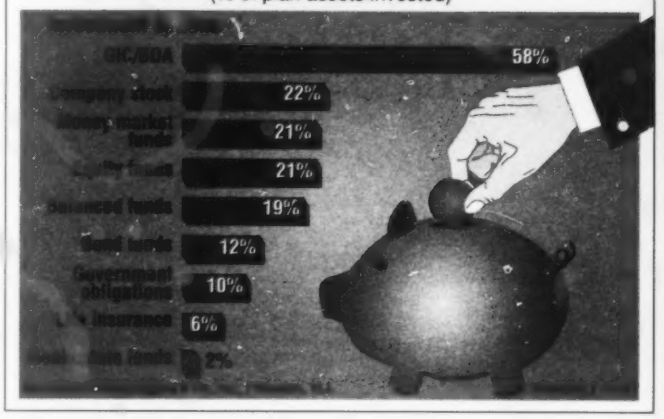
On a scale of 1 (poor) to 5 (excellent), 30% of survey participants gave a grade of 3 to the usefulness of employer-provided information about how to make good investment decisions for the retirement plan. Twenty-nine percent gave a grade of 4, while 16% graded as it as excellent, 15% gave it a 2 and 9% said it was poor.

When asked to list three things an employer could do to improve the content of the investment information, 47% said provide more information about the historical

See **Risk** *on page 28*

Employee savings plan 1991 allocations

(% of plan assets invested)



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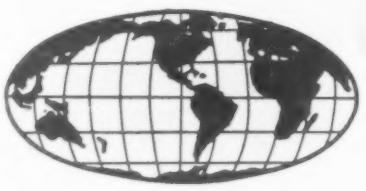

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Crossroad

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surance industry.

"Add to that the then-perceptions about the strength of the insurance companies, the guaranteed rate, and it's no wonder it proved successful," he said.

According to a recent study by A. S. Foster Higgins & Co. Inc., GICs and bank investment contracts are drawing 58% of both employer- and employee-contributed 401(k) assets. (The number likely would be higher if employer matches — which often are company stock only — were excluded.)

A major concern among plan sponsors and others is the choices employees make with their assets. The much-publicized problems

with insurance company failures, exacerbated by the participants' high concentration in those investments, have many concerned about the standard of retirement living the participants are setting for themselves.

"The fundamental difference (between 401(k)s and defined benefit plans) is that the investment experience is borne by the individuals," said Douglas Edwards, a consultant with Foster Higgins in Princeton, N.J. "Large pension plans can better absorb market fluctuations."

Others, including Karen Ferguson, director of the Pension Rights Center in Washington, say the problem with 401(k)s is companies have been more than willing to abrogate their historical role as pension provider in the name of lower cost.

"Retirement benefits is where a paternalistic approach is common sense," she said.

Instead of improving their defined benefit plans as they had in the past, she said, many employers are funneling retirement dollars into the 401(k)s as matching contributions for those employees most likely to save anyway.

Fewer than 9% of all private-sector workers with annual earnings of $25,000 put money into these plans into 1988, she said, whereas 22% of those earning more than $50,000 contributed. In dollar terms, the low-paid workers represented only 2% of employee contributions, Ms. Ferguson said.

But Mercer's Mr. Bartolai says 401(k) plans offer the tax and company-match advantages that make any savings by the lower-paid employees worthwhile, especially considering a defined benefit plan often doesn't pay off for a young, mobile worker.

"To them, the defined benefit plan means nearly nothing," he said. "It only pays off for them if they work there the rest of their lives."

And the flexibility of the 401(k) structure doesn't prohibit paternalism. One Western U.S. plan sponsor, who asked not to be identified, said his plan looks out for its participants' best interests. It has never offered its employees a GIC option because of its concern over accumulation risk. "It's not the way to save for retirement," he said.

Traditional common sense had it that retirees needed three sources for retirement income: a company plan, Social Security and their own savings. With the emphasis on 401(k) as the company plan, some analysts are worried.

"If as a society, we think that a three-legged stool is a two-legged stool, that's fine," said Pentad's Mr. Burrows. "But 401(k)s are not a substitute for a (defined benefit) pension plan."

The government, the unintended instigator of the popular plans, continuously tries to tinker with the Frankenstein it created. Realizing all of the salary reductions it wasn't able to tax, the Reagan administration tried twice in 1986 to abolish the plans. Public outrage killed those efforts, but there is always the possibility they will resurface.

"It's always going to be a target for the federal government be-

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Crossroad

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cause it's such a revenue loser altogether," said Mr. Edwards of Foster Higgins.

Nonetheless, Congress continues to grapple with the issues raised with the use of the 401(k).

"It became very clear that Congress never intended (the salary reduction plan) to have the broad implications it has today," said Kwasha Lipton's Mr. Gross.

The tinkering continues today on many fronts. Concern about the disputed tendency of plan participants to cash out when they change jobs has led to calls for greater restrictions on the ability to get a lump sum beyond the 10% tax surcharge enacted in 1986.

The Bush administration is pushing efforts to encourage wider 401(k) use through easing discrimination testing for smaller companies.

Critics say the proposal offers token benefits to rank-and-file workers in return for elimination of discrimination testing for highly paid executives.

The evolution of discrimination testing has proved to be an irritant to all sizes of 401(k) plans, even as the maximum deductions have increased to $8,400 from an initial $7,000.

Whereas Foster Higgins' Mr. Edwards said it used to be very unusual to find a plan that failed discrimination testing, Mercer's Mr. Bartolai said two out of three plans are having trouble passing the test today because the lower-paid workers aren't participating and/or contributing at the levels that the highly compensated are.

The plans are getting their share of attention from regulators. The Department of Labor has proposed guidelines for investment options to encourage a broad range of choices for plan participants, and the Financial Accounting Standards Board is studying whether to require plans to fairly value GIC investments.

401(k)s also have been increasingly wooed by investment managers and other service providers. Product innovation, particularly in the employee communication, service bundling, plan design and investment management fields, continues at a rapid pace.

And with the ability of 401(k) plans to adapt themselves to the delivery of health benefits, more corporate executives are are looking at them as an aid in containing medical costs.

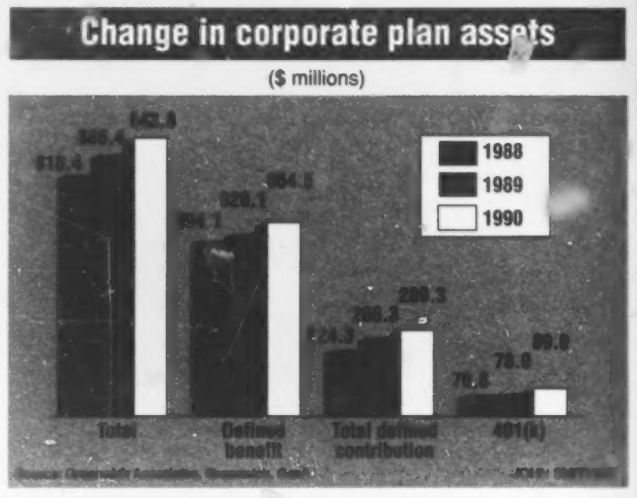
All this portends continued change for 401(k) plans.

"One of the big pushes we will see in the 401(k) plans is the change in focus to a retirement vehicle," said Mr. Edwards of Foster Higgins. "Another is that over the next couple of years, the effort will be to make participants smarter investors. It's also in the plan sponsors' best interests because it takes the pressure off them to increase funding or benefit levels of the defined benefit plans."

There is no doubt 401(k) plans will continue to grow, despite the issues their popularity raises. The increasing responsibilities of plan participants to self-direct their retirement incomes have led in recent months to an urgent focus on educating them in the wisdom of specific investment practices.

As with the evolution of all policies, the government's actions, intended or not, will play a major role in plan sponsors and participants being able to meet the goals of retirement benefits. New issues are bound to develop, but the adaptability of the 401(k) structure will help it face the challenges ahead, industry observers say.

It is still a young industry, and as such, will face the normal growing pains of any 10-year-old. ■



Risk

Continued from page 21

returns of the available options; 47% also called for clearer explanations of the pros and cons of each investment choice; and 45% said a clearer and simple explanation of what each investment choice is.

"To me it demonstrates people want more information on how their investments work," Mr. LoRusso said.

Ten percent said no improvements were needed and 30% said they could use better information about how much money would be needed to live on in retirement.

"We have to get people to think a little more about their investment horizons," Mr. LoRusso said. "The implications are very serious. How can we in English best explain how these work without confusing them?"

A Hancock commentary released with the survey said participants indicated their top choices for delivery of investment information were written material and knowledgeable people they could contact. "Participants' negligible level of interest in the video format could perhaps be attributed to a low level of comfort at present with this medium as an educational tool," the commentary said. ■

HARRIS CONVERSATIONS FOR THE 90s:

PLAYING ON THE SAME SIDE

A SPECIAL DISCUSSION WITH DR. STANLEY S. GRYSKIEWICZ
and a select group of business executives.

Playing on the same side of the corporate team is vital when it comes to innovation, whether creating a new product or developing new ways of thinking and managing within a company.

Yet too often, corporations separate researchers, designers, and planners from those who turn their visions into reality. Thus millions of dollars are wasted on concepts that are instantly recognized as unworkable by those who must implement them.

Harris Master Trust Services and Harris Investment Management, Inc., recently invited Dr. Stanley Gryskiewicz of the Center for Creative Leadership to conduct a workshop on this issue for a select group of the bank's customers.

Dr. Gryskiewicz focused on how the creative and team-building processes are affected when planners and implementors are separated. The following recounts several of his key principles for managing innovation:

Frequently you are not certain exactly what it is you are trying to accomplish, let alone how to do it.

Implementors who are kept out of the planning process often have high anxiety levels. They worry about what task they'll be held responsible for and whether they'll be able to accomplish it.

This anxiety can play itself out in destructive ways. For example, I've had workshops in which planners and implementors are supposed to work together to assemble a puzzle of a hollow square. Some planners put together the entire puzzle, except for one piece, never telling the implementors about the puzzle or what their job will be. So when the planners finally tell the implementors to put the last piece in the puzzle, the implementors can't believe that's all they have to do. They don't trust the planners—and simply walk away without completing the puzzle. So the whole team fails at the task.

Even in simple tasks, communication can be a problem, but participation improves communication.

When you hold back information or keep implementors in the dark, emotions like anger and anxiety will proliferate. That emotion does not simply go away, either.

Instead, it will hide, then show itself later in other projects involving the same people. Then you'll have to solve the so-called people problems before you can do any meaningful work on the task. So you can't think of negative feelings as an unavoidable by-product of the planning/implementing process. You must resolve these feelings or a project could be sabotaged by them.

The earlier in the planning the implementors are involved, the more effective is the process.

People often tell me that while this sounds like a good idea, it's unworkable in business settings. They say sometimes you just can't provide the big picture to the implementors.

I say, in those situations, you need to redefine who your implementors are. There's probably a select group of them that could and should know more—especially when you need their commitment to ensure a quick, high-quality turnaround.

The line between competing as a leader and cooperating as a colleague is frequently so fuzzy that it is nonexistent.

A single team consists of planners and implementors. But we tend to think in terms of separate, often competing teams, just because members of one team have different labels. We may even encourage these divisions because they seem to make our jobs, and our selves, more important, more privileged.

Assumed constraints are usually more restrictive than actual constraints; and what is clever, creative, and effective to one person may be distasteful, devious, and cheating to another.

These two principles often are interconnected. For instance, in the hollow square puzzle I mentioned earlier, planners sometimes draw a key to the puzzle. The rules say simply that the planners can't show the original puzzle key to the implementors. So, is redrawing the key cheating or an innovation?

Disagreements like these often crop up when you are pushing boundaries and limits that may no longer be appropriate. So be certain that team members agree about what is legal, ethical, and finally, what is right.

But be willing to test the limits. Your current safe boundaries were once unknown frontiers. It may be time to invoke the spirit of the pioneer, the innovator, and move ahead.

This is the fifth in a series of Harris Conversations for the 90s. Other topical roundtables that can help our Harris customers be more competitive will follow.

To receive a longer version of this workshop discussion with Dr. Stanley Gryskiewicz, call Harris Bank at (312) 461-5554.

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